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Date 7/27/84

Surname [REDACTED]

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[REDACTED]

[REDACTED]

EIN: [REDACTED]
Key District: Atlanta

APR 6 1994

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(c)(3) of the Internal Revenue Code. We have determined that you do not qualify for exemption under that section of the Code. Our reasons for this conclusion and the facts upon which it is based are explained below.

The information submitted indicates you were incorporated on [REDACTED]. You submitted an application for recognition of exemption under section 501(c)(7) of the Code on [REDACTED], but failed to establish exemption under that section. On [REDACTED], you submitted Form 1023, an application for recognition of exemption under section 501(c)(3) of the Code.

The purpose stated in your initial Articles of Incorporation is -

...to promote the educational and artistic talent of young women in [REDACTED], [REDACTED] and [REDACTED] Counties. This aim shall be accomplished by annually organizing, producing, and promoting eventual winners.

You amended your Articles of Incorporation on [REDACTED], to restate your purposes as:

...exclusively for charitable, religious, educational and scientific purposes, including for such purposes, the making of distributions to organizations that qualify as exempt organizations under section 501(c)(3) of the Internal Revenue Code...

You indicated in your submission that since [REDACTED] your sole activity has been the conduct of a local pageant known as the [REDACTED]. Until [REDACTED], your Pageant was part of the feeder system for the Miss America Pageant. Your contract with [REDACTED] required that you abide by all the rules and

regulations set forth by the Miss America Pageant. The Contestant Contracts required all contestants to accept and abide by these rules.

Included in the Contestant Contract was a provision regarding a non-revocable scholarship to be awarded to the winners of the pageant. To be eligible to win the scholarship, a contestant must first have participated fully in the pageant. Full participation prior to the final selection of a winner included participation in the contest including rehearsals and final performances. It also included a series of events leading up to final selection such as public appearances, television and radio broadcasts, personal appearances, interviews, still photos, and video and audio tapes.

In a letter dated [REDACTED], we explained the Internal Revenue Service's published position regarding organizations that conduct beauty pageants. The Service position, affirmed by the Tax Court in Miss Georgia Scholarship Fund, Inc. v. Commissioner, 72 T.C. 267 (1979), is that such organizations are not described in section 501(c)(3) of the Code.

In response to our letter, you have submitted additional information. You indicate that your contract with the [REDACTED] [REDACTED], expired on the last day of [REDACTED], and will not be renewed. You have revised your procedures as follows:

- a. Each contestant must fill out and sign a Contestant Contract to be eligible to win a scholarship.
- b. Each contestant must fill out and sign a fact sheet.
- c. All of the contestants are requested to come to an orientation.
- d. All of the contestants are asked to come to approximately 4 pageant rehearsals where they practice a routine which they perform together at the finals. They are also taught stage presence and the order of competition for finals.

The Contestant Contract that you will use contains the following terms and conditions:

"In consideration of my admission as a contestant in the forthcoming Pageant, including my right to compete for, and if successful, to participate in the grant of scholarships, I do hereby agree as follows:

1. I agree to participate in the series of events leading up to the final selection of "[REDACTED]" [REDACTED] which event will commence on a date to be

[REDACTED]

determined by the Pageant, and to abide by, and be bound by these rules and regulations governing the Finals of the Pageant, and the awarding and supervision of scholarships.

2. I agree that the manner and method of conducting the Finals of the Pageant shall be in the sole discretion of the Pageant, and I further agree that the time, method and manner of judging the Finals of the Pageant and the award and supervision of the Pageant scholarships shall be within the sole discretion of the Pageant, and that the decision of the persons designated to judge the various events in any and all matters pertaining to the selection of the winner shall be final.

3. I understand that sponsorship contributions will be provided by certain companies to the Pageant, and I agree that at no time during the period I hold the title of [REDACTED], will I endorse or permit my name or likeness to be used in connection with the endorsement or advertisement of any product or products competitive to any of the companies which make said sponsorship contributions except with the consent, in writing, of the Pageant.

4. If I am selected [REDACTED]:

a. I will serve as "[REDACTED]" until my successor is selected or appointed.

b. I irrevocably constitute and appoint the Pageant, commencing at the time I am crowned until the time I relinquish that crown, as my sole and exclusive agent, representative and attorney in fact, solely as it pertains to representing the "[REDACTED]" and the title "[REDACTED]".

c. It is understood that I am and will remain an independent contractor with respect to my relationship with the Pageant and am not an employee thereof.

d. The Pageant shall have the right to choose and designate my chaperon and traveling companion, if any, during the year commencing at the time I am crowned.

[REDACTED]

e. I agree that after the conclusion of my reign as "[REDACTED]", I will not make public appearances wearing my crown nor will I make public appearances as "[REDACTED]", a Former [REDACTED], for the purpose of advertising or endorsing any product, person or service unless pre-approved by the Pageant.

5. If any of the representations and warranties made by me ... are false or if I am selected as "[REDACTED]" and engage in any of the acts or activities involved in Paragraph 1 during the year of my reign or I otherwise fail to conduct myself in a manner, which in the opinion of the Pageant does not uphold and maintain the dignity and honor of the title..., or if I suffer any disability which in the sole and exclusive judgment of the Pageant impairs my ability to perform the duties expected of me as "[REDACTED]", then I understand and agree that the Pageant may, at its exclusive option, terminate my right to participate in the ... Pageant, as well as my right to the title ...

6. If I am selected as first, second, or third or fourth runner-up to the title ... I agree to be available to succeed to "[REDACTED]" as set forth herein, if for any reason the original "[REDACTED]", or the prior runners-up are unable or ineligible to act ..."

You state further that the winner of the pageant, [REDACTED], will promote herself and the County of [REDACTED] during her reign by attending Chamber of Commerce functions such as monthly meetings. She may also attend ribbon cuttings and openings, ride a parade float, and carry on other activities designed to help build a well rounded person. These activities are voluntary and the scholarship funds are not dependant upon the winner taking part in any activities after the pageant.

Since your inception, you have raised funds for this activity in several ways. Your sources of funds to date include the sale of ads in your Program book, pageant ticket sales, contestant sponsorships, car washes, and a dance. The participants are not required to raise funds but they and their families are encouraged to participate in your fund-raising activities.

You have indicated that in the future you plan to raise funds for your scholarships through the conduct of a Bingo game.

[REDACTED]

You have not commenced this activity but indicate that a bingo game will be conducted weekly. Based on your increased income from this source, you state that you will be able to increase the number and amount of scholarships and grants awarded.

Section 501(c)(3) of the Internal Revenue Code provides for the exemption from federal income tax of organizations which are organized and operated exclusively for charitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that an organization must be both organized and operated exclusively for one or more of the purposes specified in section 501(c)(3) of the Code in order to be exempt as an organization described in such section.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it is engaged primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(d)(ii) of the regulations states that an organization is not organized or operated for one or more exempt purposes unless it serves a public rather than a private interest. Accordingly, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator, shareholders, or persons controlled, directly or indirectly, by such private interests.

Section 117(a) of the Code provides, in relevant part, that gross income does not include any amount received as a qualified scholarship. Section 117(c) imposes a limitation thereon, however, and specifies that the exclusion for "qualified scholarships" shall not apply to that portion of any amount received which represents payment for teaching, research, or other services by the student required as a condition for receiving the qualified scholarship.

Section 1.117-3(a) of the Income Tax Regulations defines the term "scholarship" to generally mean an amount paid or allowed to, or for the benefit of, a student pursuing his studies.

Section 1.117-4(c)(1) of the regulations provides that any amount paid or allowed to, or on behalf of, an individual to

enable him to pursue studies or research shall not be considered to be amounts received as a scholarship grant under section 117 if such amount represents either compensation for past, present, or future employment services or represents payment for services which are subject to the direction or supervision of the grantor.

In accordance with the principles states above, Rev. Rul. 66-103, 1966-1 C.B. 134, ruled that an organization whose primary activity is to provide awards and grants, including scholarship and fellowship grants to needy individuals who would otherwise not be able to pursue their studies for lack of funds and with no monetary benefits to the donor organization, qualifies for exemption under section 501(c)(3) of the Code. The organization is primarily engaged in the charitable activity of providing relief of the poor.

Similarly, Rev. Rul. 69-257, 1969-1 C.B. 151, states that an organization providing scholarships selected from a broad class of applicants, on the basis of scholastic standing, qualifies for exemption under section 501(c)(3) of the Code. The organization advances education as that term is used in the statute.

However, Rev. Rul. 68-20, 1968-1 C.B. 55, states that under section 117 of the Code, a scholarship is includable in the gross income of a beauty pageant winner as compensation for participating in the contest, playing a leading role in the televised pageant, and performing subsequent services for, or at the direction of, the sponsoring corporation. This ruling is supported by a Supreme Court interpretation of section 117. In Bingler v. Johnson, 394 U.S. 741, 751 (1969), the Supreme Court stated that to be excluded from gross income under section 117 of the Code, a scholarship must be "relatively disinterested, no strings educational grants, with no requirements of any substantial quid pro quo from the recipients."

Miss Georgia Scholarship Fund, Inc. v. Commissioner, supra, involved an organization formed for the purpose of giving scholarships to contestants in the Miss Georgia Pageant. The participants were required, as a condition for qualifying for scholarships, to enter into a contract that obligated them to participate in the local pageant. In the event they were selected to participate in the Miss America Pageant, they were also obligated to abide by the rules and regulations of that contest, including participation in public appearances and the like. The scholarships were unavailable to those contestants who failed to execute the contestant's contract. The Tax Court stated that the principal issue in its decision was whether the purported "scholarships" were described in section 117 or section 74 of the Code, or were compensatory in nature. The Court found

[REDACTED]

that the scholarships being offered were, in fact, compensatory in nature, i.e. payments for the contestant's agreement to perform the requirements of the contestant's contract, and not scholarships within the meaning of section 117. Further, the Court held the organization was not exempt under section 501(c)(3) of the Code because it was operated primarily for the purpose of providing compensatory payments to contestants in the pageants.

Better Business Bureau v. United States, 316 U.S. 279 (1945), holds that the existence of a single non-exempt purpose, if substantial in nature, will destroy the exemption under section 501(c)(3). The Court stated that while some of the organization's activities were educational, a substantial purpose of the organization was to promote business; thus, the organization was not operated exclusively for educational purposes.

You represent that the payments you make to winning contestants are scholarships. However, this issue has been previously litigated in Miss Georgia Scholarship Fund Inc., supra. Although you have severed your ties with the Miss America Pageant, you continue to operate in a manner similar to the organization described in that case.

The information you submitted indicates that an individual is required to execute a Contestant's Agreement before entering the pageant. The Agreement requires prospective contestants to provide warranties and representations including her agreement to perform certain services and to refrain from certain activities in order to be accepted in the pageant and to be eligible to receive a scholarship. One such activity, for example, is contained in paragraph 3 of the Contestant's Agreement. A contestant is required to refrain from endorsement or advertisement of any product competitive to the products of any of the major sponsors of scholarship funds. A scholarship, once won, is not revocable in the event a Contestant breaches the contract. However, no contestant can win a scholarship without first executing the Agreement and complying with many of its terms.

In light of the terms of the Contestant's Agreement, and the provisions therein respecting personal service obligations on the part of the contestants and selectees, we conclude that the "scholarships" awarded are clearly payments for past, present, and future services by the contestants. These services include participation in the pageant. Your "scholarship" awards are in the nature of compensation for executing the Contestant's Agreement, and for entering, participating in, and winning a

title in your pageant. Therefore, such awards are not scholarships within the meaning of section 117 of the Code.

Because one of your substantial purposes is providing compensatory payments to contestants in the pageant, you are not operated exclusively for one or more exempt purposes specified in section 501(c)(3) of the Code. Furthermore, by engaging primarily in the activity of providing compensation to contestants who are obligated to perform certain services for your organization, you are serving private rather than public interests. Therefore, we conclude that you are not operated exclusively for one or more exempt purposes within the meaning of section 501(c)(3) of the Code and section 1.501(c)(3)-1(d)(1)(i) of the regulations. Except for your nonforfeiture of "scholarships," we find you to be analogous to the organization in Miss Georgia Scholarship Fund, Inc., supra, which was determined not to qualify for exemption under section 501(c)(3).

You are distinguishable from the organizations described in Rev. Ruls. 66-103 and 69-257. The scholarship awards provided by these organizations were based on criteria designed to accomplish charitable purposes. In Rev. Rul. 66-103, exemption was based on the fact that the awards were given to needy individuals. Financial need is not a factor in your selection process. In Rev. Rul. 69-257, the basis for granting the scholarships was scholastic achievement. Scholastic ability does not appear to be a factor in your selection process. You are operating a program that is similar to the program described in Rev. Rul. 68-20. The scholarship described therein was determined to be includable in the gross income of the winner as compensation for participating in the contest. Such compensatory awards serve private purposes.

In conclusion, we find that you do not qualify for exemption under section 501(c)(3) of the Code. You are required to file federal income tax returns on Form 1120. A scholarship or fellowship grant that represents payment for services under section 117(c) is considered "wages" for purposes of section 3401(a). Additionally, the grantor of such amounts is subject to certain filing requirements respecting wages. See Notice 87-31, 1987-1 C.B. 475, a copy of which is enclosed.

Contributions to you are not deductible under section 170 of the Code.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a

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right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If you do not protest this proposed ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the U.S. Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to your key District Director. Thereafter, any questions about your federal income tax status should be addressed to that office. The appropriate State officials will be notified of this action in accordance with Code section 6104(c).

You will expedite our receipt of your reply by using the following address on the envelope:

Internal Revenue Service
1111 Constitution Avenue
Washington, D.C. 20224
Attn: [REDACTED]

Sincerely yours,

[REDACTED]
[REDACTED]
Chief, Exempt Organizations
Rulings Branch 4

Enclosure:
Notice 87-31

cc: [REDACTED]

cc: State Officials
[REDACTED]

3/8/94

3/11/94